FREQUENTLY ASKED QUESTIONS (FAQ)
BANK INDONESIA REGULATION NO. 16/21/PBI/2014
CONCERNING THE IMPLEMENTATION OF PRUDENTIAL PRINCIPLES IN MANAGING EXTERNAL DEBT OF NON-BANK CORPORATION
AND
CIRCULAR NO. 16/24/DKEM
CONCERNING THE IMPLEMENTATION OF PRUDENTIAL PRINCIPLES IN MANAGING EXTERNAL DEBT OF THE NON-BANK CORPORATION

1. Q: **What is the background behind the issuance of this BI regulation (PBI)?**

   A: The amount of private external debt has continued to spiral, even surpassing that of the government. Over the past decade, total private sector external debt has increased three-fold from US$54.3 billion at the end of 2005 to US$159.3 billion at the end of September 2014, accounting for 54.5% of total external debt in Indonesia. A Bank Indonesia review shows that private external debt is vulnerable to a number of risks, primarily currency risk, liquidity risk and overleverage risk. Currency risk is high because the majority of private external debt is utilised to finance domestic-oriented companies that generate earnings in rupiah but repay their external debt in a foreign currency. Vulnerability to currency risk is also increasing due to a lack of hedging instruments in the nonbank corporate sector. Liquidity risk is also escalating as the value and share of short-term private external debt increases. Meanwhile, a mounting debt-to-income ratio is indicative of an increase in overleverage risk.

   Risk inherent with private external debt is intensifying because the economic outlook is replete with uncertainty. Global liquidity is projected to tighten, with higher interest rates on the horizon as advanced countries taper off accommodative monetary policy, especially in the United States. Simultaneously, the economies of emerging market countries, as leading trading partners of Indonesia, are projected to continue moderating and export commodity prices on the international market remain low. Such conditions have the potential to exacerbate the repayment burden of external debt and therefore undermine repayment capacity.

2. Q: **What is the objective of the BI Regulation?**

   A: The regulation aims to mitigate the various risks inherent with private external debt, specifically at nonbank corporations, the total of which has soared over the past several years. The aforementioned risks include currency risk, liquidity risk and overleverage risk. Prudential principles are applied paying due regard to best practices of business management to ensure business continuity and that investment activity is maintained.

3. Q: **Why does Bank Indonesia need to regulate prudential principles for nonbank corporate external debt when the actual number of nonbank foreign loans that have experienced default is inconsequential?**

   A: It is true that the number of nonbank foreign loans that experience default is currently very small. An internal or external negative shock, however, would exacerbate default risk, which has the potential to disrupt financial system and macroeconomic stability similar to that which occurred during the 1997/1998 crisis because the majority of corporations holding external debt do not apply adequate risk mitigation.

4. Q: **Why does Bank Indonesia need to regulate hedging activity when so few corporations are currently engaged in such activity?**

   A: The number of nonbank corporations engaged in hedging activity and the volume of hedging transactions are currently low. Based on the data, however, although the majority of nonbank corporations do not engage in hedging activity, they are exposed to currency risk. Furthermore, the BI regulation also endeavours to standardise the practice of hedging required by all nonbank corporations holding foreign debt.

5. Q: **How is external debt defined in this BI regulation?**

   A: External debt is defined in this BI regulation as Resident debt to Non-Resident in a foreign currency and/or the rupiah, including financing based on sharia principles.

6. Q: **To whom does this BI regulation apply?**

   A: All nonbank corporations holding external debt in foreign currency. However, the calculation of corporate foreign currency liabilities controlled by this regulation also includes foreign currency liabilities to residents.

7. Q: **Does this BI regulation restrict external debt?**

   A: This BI regulation does not intend to restrict external debt but rather strengthen nonbank corporate risk management in the face of widespread uncertainty in the global and domestic economies moving forward.

8. Q: **What prudential principles are included in this regulation?**

   A: Prudential principles in this regulation include the minimum hedging ratio, minimum liquidity ratio and minimum credit rating.

9. Q: **What is the Hedging Ratio?**

A: The hedging ratio is the total value of a position protected by a hedge with the negative balance of:

- Foreign Currency Assets to Foreign Currency Liabilities with a maturity period of up to three months since the end of the quarter. This can be expressed mathematically as follows:
  Hedging Ratio = [Foreign Currency Assets – Foreign Currency Liabilities up to 3 months] x (25%)
- Foreign Currency Assets to Foreign Currency Liabilities with a maturity period of three to six months since the end of the quarter, which can be expressed mathematically as follows:
  [Foreign Currency Assets – Foreign Currency Liabilities ≥3 months to 6 months] x (25%)

10. Q: **What is the Liquidity Ratio?**

A: The liquidity ratio is the amount of total foreign currency assets adequate to meet foreign currency liabilities that will mature within three months from the end of the quarter. This can be expressed mathematically as follows:
Foreign currency assets ≤ 3 months/Foreign currency liabilities ≤ 3 months x 100%

11. Q: **What are Foreign Currency Assets?**

A: Foreign Currency Assets are current assets denominated in a Foreign Currency used to calculate the Hedging Ratio and Liquidity Ratio.
Foreign Currency Assets consist of cash, demand deposits, savings accounts, term deposits, receivables, inventory, marketable securities as well as receivables originating from forward, swap and/or option transactions.

12. Q: **Can foreign currency term deposits that mature in more than six months be considered Foreign Currency Assets?**

A: Yes. All Foreign Currency term deposits owned by corporate at the end of the reporting quarter can be considered an asset without observing the maturity date of the term deposits.

13. Q: **Can all receivables be considered Foreign Currency Assets?**

A: Receivables that can be considered Foreign Currency Assets consist of trade receivables to residents and non-residents that mature within three months from the end of the quarter and/or three to six months from the end of the quarter, unconditional and irrevocable. Not all trade receivables to residents can be considered Foreign Currency Assets. Trade receivables to Residents that can be considered Foreign Currency Assets must have a contract or agreement signed prior to 1st July 2015. Trade receivables to Residents signed after 1st July 2015 can be considered a component of Foreign Currency Assets if linked to a strategic infrastructure project and approved by Bank Indonesia.

14. Q: **What are the requirements for inventory to be considered a Foreign Currency Asset?**

    A: Inventory can be considered a Foreign Currency Asset if the corporation is an exporter, namely the corporation has a ratio of export revenue to total revenue exceeding 50% in the previous calendar year.

15. Q: **How is the value of inventory recognised in the components of Foreign Currency Assets owned by an exporter?**

    A:
    1. Finished goods/ready for sale are calculated at 100%;
    2. Intermediate goods are calculated at 50%; and
    3. Raw materials are calculated at 25%.

    Inventory that are considered as Foreign Currency Assets does not include tools and equipment.

16. Q: **Why are fixtures and equipment not considered as foreign currency assets?**

    A: Because tools and equipment are production support factors and not a source of revenue that can produce Foreign Currency Assets in normal business activity.

17. Q: **What are marketable securities?**

    A: Marketable securities are those that can readily be exchanged for cash with an observable market price, available for sale and with a maturity date of less than six months. Marketable securities include debt instruments and equity instruments.

18. Q: **What is the scope of off balance sheet assets that can be used as a component of calculating the negative balance between foreign currency assets and foreign currency liabilities?**

    A: Applicable off balance sheet assets only include forward, swap and/or option transactions initiated prior to the reporting quarter. In other words, forward, swap and/or option transactions initiated in the reporting quarter are not a component of foreign currency assets because such transactions are intended to fulfil the minimum hedging ratio.

19. Q: **How are receivables originating from forward, swap and/or option transactions calculated as a component of Foreign Currency Assets?**

    A: Receivables originating from forward, swap and/or option transactions are calculated as a component of Foreign Currency Assets according to the notional amount that matures within three months and/or between three and six months from the end of the quarter.

20. Q: **Are Cross Currency Swaps (CCS) recognised as hedging activity pursuant to this BI regulation?**

    A: Yes, pursuant to this regulation swap transactions also include CCS transaction, namely an agreement or contract between two parties to exchange interest payments and principals denominated in two different currencies.

21. Q: **What are Foreign Currency Liabilities?**

    A: Foreign Currency Liabilities are current liabilities denominated in a Foreign Currency used when calculating the Hedging Ratio and Liquidity Ratio. Foreign Currency Liabilities are regulated in more detail pursuant to the Bank Indonesia Circular concerning the Application of Prudential Principles to Manage Nonbank Corporate External Debt.

    Foreign Currency Liabilities include all foreign currency liabilities to residents and non-residents, including liabilities originating from forward, swap and/or option transactions that mature within three months and/or three to six months from the end of the quarter.

22. Q: **What if there is no negative balance between Foreign Currency Assets and Foreign Currency Liabilities?**

    A: If there is no negative balance, non-bank corporations are not required to fulfil the minimum Hedging Ratio.

23. Q: **What if the negative balance between Foreign Currency Assets and Foreign Currency Liabilities is below the threshold?**

    A: Non-bank corporations with a negative balance between Foreign Currency Assets and Foreign Currency Liabilities below the threshold, namely US$100,000, or equivalent, are not required to fulfil the minimum Hedging Ratio.

24. Q: **What if hedging transactions to meet the minimum Hedging Ratio are settled not with banks in Indonesia?**

    A: Hedging transactions settled not with banks in Indonesia after 1st January 2017 are not considered as fulfilment of the minimum Hedging Ratio or minimum Liquidity Ratio. Receivables that emerge in such transaction are also not considered a Foreign Currency Asset.

25. Q: **Are non-bank corporations that record their financial statements in US Dollars (the functional currency is in US Dollars) exempt from the Hedging Ratio?**

    A: Non-bank corporation are exempt from the Hedging Ratio if:

a. have permit from the RI Ministry of Finance to bookkeep in US Dollars; and
b. The ratio of export revenue to total revenue in the previous calendar year exceeds 50%.

26. Q: **Export-oriented corporations have a natural hedge against foreign currency exposure. Therefore, isn't it true that the hedging requirement as stipulated in this Bank Indonesia Regulation actually creates unnecessary additional costs due to double/over-hedge?**

A: According to this regulation, inventory owned by exporters, namely corporations with more than 50% of their revenue stemming from exports, is considered a Foreign Currency Asset. Receivables are also considered a Foreign Currency Asset. Inventory and receivables play a crucial role in providing a natural hedge for exporters. By including inventory and receivables as Foreign Currency Assets in this regulation, exporters will avoid double/over-hedge. In addition, exporters are also exempt from the minimum Hedging Ratio if licensed to bookkeep in US dollars.

27. Q: **What is a credit rating?**

A: A credit rating is the rating given by a rating agency to illustrate the credit worthiness of a corporation.

According to this BI regulation, non-bank corporations engaged in external debt activities shall have a credit rating of no less than BB- or equivalent as issued by a Rating Agency recognized by Bank Indonesia.

This requirement shall be effective for external debt signed or issued after 1st January 2016, but not applicable to refinancing (if additional outstanding is below the threshold), external debt to finance infrastructure projects obtained from an international creditor (bilateral/multilateral), external debt for central and local government infrastructure projects, external debt guaranteed by an international institution (bilateral/multilateral) as well as trade credit and other loans.

28. Q: **Which types of credit rating can be used and when they should be issued?**

A: Corporation can use credit rating of corporate (issuer rating) and/or credit rating of debt securities (issue rating) pursuant to the type and maturity of the external debt. In other words, if a corporation engages in external debt activity by issuing a long-term security, then the credit rating used shall also be long term.

The validity of the issuer rating and/or issue rating is no more than two years after the issuance of the rating.

29. Q: **Is a non-bank corporation permitted to use the credit rating of its parent company in order to engage in external debt activity with a third party other than the parent company?**

A: A nonbank corporation is permitted to use the credit rating of its parent company to engage in external debt activity with third parties if:

a. The external debt is guaranteed by the parent company; or
b. The corporation began commercial operation within the preceding three years.

30. Q: **Which debt instruments can be used for a corporation to engage in a loan agreement?**
A: Corporations must use an issuer rating.

31. Q: **Which institutions are included as international bilateral/multilateral creditors?**
A: Examples of international bilateral/multilateral creditors include the International Finance Corporation (IFC), Japan bank for International Cooperation (JBIC), Japan International Cooperation Agency (JICA), Asian Development Bank (ADB) and Islamic Development Bank (IDB). A list of international institutions is contained within Attachment II of this Circular Letter.

32. Q: **Which rating agencies are recognized by Bank Indonesia pursuant to this regulation?**
A: There are currently three domestic and five international rating agencies recognized by Bank Indonesia, namely:

Name of Rating Agency		**BB- Equivalent Rating**
Domestic Rating Agencies	PT Pemeringkat Efek Indonesia (PEFINDO)	idBB-
	Fitch Ratings Indonesia	BB-(idn)
	PT. ICRA Indonesia	(Idr)BB-
International Rating Agencies	Moody’s Investors Service	Ba3
	Standard & Poor’s	BB-
	Fitch Ratings	BB-
	Japan Credit Rating Agency	BB-
	Rating and Investment Information Inc.	BB-

33. Q: **Can a corporation use a credit rating from a rating agency not approved by Bank Indonesia?**
A: No. Non-bank corporations must use a credit rating issued by a rating agency recognized by Bank Indonesia. Rating agencies that want to be included on the list can submit a request to Bank Indonesia.

34. Q: **If a corporation has a credit rating issued by a domestic rating agency and an international rating agency, which one is applicable?**

A: Corporations can use a credit rating from either a domestic or international rating agency recognized by Bank Indonesia. The credit rating of a domestic rating agency is considered equivalent to that of an international rating agency.

If a corporation has a split rating from two or more rating agencies, use of the higher credit rating shall be permitted.

35. Q: **Does this Bank Indonesia Regulation and Circular regulate reporting activity? Who can corporations contact in relation to reporting activity?**

A: This Bank Indonesia Circular does not regulate reporting activity. Reporting activity is regulated according to the Bank Indonesia Regulation concerning the reporting of foreign exchange flows and reporting of the implementation of prudential principles in managing external debt of the non-bank corporation. Correspondence regarding reporting activity should be forwarded to:

Bank Indonesia
cq. Departemen Pengelolaan dan Kepatuhan Laporan (DPKL)
Menara Sjafruddin Prawiranegara, Lantai 5
Jl. M.H. Thamrin No.2
Jakarta 10350

36. Q: **Which sanctions are applicable for violations of this regulation?**

A: Non-bank corporations caught in violation of this regulation concerning prudential principles will face administrative sanctions in the form of a written warning. In addition, Bank Indonesia will submit details concerning the imposition of administrative sanctions to relevant parties as follows:

a. International creditors involved;
b. The Ministry of State Enterprises, applicable to state-owned enterprises;
c. The Ministry of Finance, Directorate-General for Taxation;
d. The Financial Services Authority (OJK); and
e. The Indonesia Stock Exchange, applicable to corporations listed on the Indonesia Stock Exchange.

37. Q: **When will the sanctions be imposed?**

A: Sanctions will be imposed commencing the fourth quarter of 2015.

38. Q: **When will this BI regulation become effective?**

A: This Bank Indonesia Regulation will become effective on 1st January 2015 as follows:

Regulation Key Points	1 Jan 2015 to 31 Des 2015	1 Jan 2016 to 31 Des 2016	Starting 1 Jan 2017
Hedging Ratio	≤ 3 Mo: 20% > 3 to 6 Mo: 20%	≤ 3 Mo: 25% > 3 to 6 Mo: 25%	
Liquidity Ratio	≤ 3 Mo: 50%	≤ 3 Mo: 70%	
Credit Rating	-	Starting Jan 1st 2016	
Hedging Transaction to fulfill minimum Hedging Ratio	Not necessarily settled with banks in Indonesia		Must settled with banks in Indonesia
Administrative Sanction	Applicable starting Q4-2015	Applicable	